

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition of ROBERT C. FRIEDMAN for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1980 through 1983.	: : : : : : : : : : :	DETERMINATION
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Petitioner, Robert C. Friedman, Krumkill Road, RD #1, Slingerlands, New York 12159, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1980 through 1983 (File No. 802070).

A hearing was held before Arthur S. Bray, Hearing Officer, at the offices of the State Tax Commission, Building #9, W. A. Harriman State Office Building Campus, Albany, New York, on February 24, 1987 at 10:45 A.M., with additional documents to be filed by June 12, 1987. Petitioner appeared by Urbach, Kahn & Werlin (David L. Evans, C.P.A.). The Audit Division appeared by John P. Dugan, Esq. (Thomas C. Sacca, Esq., of counsel).

ISSUES

- I. Whether it was necessary for the Audit Division to provide a foundation prior to the admission into evidence of the Notice of Deficiency.
 - II. Whether the notices of deficiency were duplicative.
 - III. Whether petitioner was a shareholder within the meaning of Tax Law § 612(b)(7), (8) and (9) and therefore required to make the modifications set forth in those sections increasing his Federal adjusted gross income.
 - IV. Whether the Audit Division properly disallowed petitioner's entertainment expenses and rental expenses.
- FINDINGS OF FACT

1. Petitioner, Robert C. Friedman, filed New York State resident income tax returns for the years 1981 through 1983. Petitioner claimed travel and automobile expenses as well as rental

expenses during the years 1981 through 1983. For the year 1983, he also claimed professional education and entertainment expenses. On each of the returns, petitioner made the professional corporation modifications prescribed by Tax Law § 612(b)(7), (8) and (9).

2. On or about April 27, 1984, petitioner filed New York State amended resident income tax returns for the years 1980 through 1983. The amended returns claimed refunds on the basis of petitioner's position that he erroneously made the foregoing professional corporation modifications since he was not a shareholder of a professional corporation. The claims for refund for the years 1980 through 1983 were mailed to the Albany District Office of the Department of Taxation and Finance on or about April 27, 1984. The amended return for the year 1980 reported that a return had previously been filed for 1980 and that tax was paid during 1980 through withholding of New York State tax. The return for 1980 was filed pursuant to a grant of an extension of time for petitioner to file his Federal income tax return to October 15, 1981. The Audit Division did not respond to petitioner's claims for refund.

3. On March 29, 1985, the Audit Division issued a Notice of Deficiency to petitioner, Robert C. Friedman, asserting a deficiency of personal income tax as follows:

<u>Year</u>	<u>Tax</u>	<u>Interest</u>	<u>Total</u>	
1981		\$1,592.00	\$ 567.31	\$2,159.31
1982		1,015.00	208.56	1,223.56
1983		<u>3,212.00</u>	<u>321.26</u>	<u>3,533.26</u>
		<u>\$5,819.00</u>	<u>\$1,097.13</u>	<u>\$6,916.13</u>

4. On April 12, 1985, the Audit Division issued a second Notice of Deficiency to petitioner asserting the same deficiency of personal income tax which had been asserted on March 29, 1985.

5. Each of the foregoing notices of deficiency were received in evidence without requiring a foundation.

6. The Statement of Audit Changes, which was issued on December 31, 1984, explained that the notices of deficiency were based on adjustments of petitioner's liability in five areas. First, the Audit Division took the position that the amount of the professional corporation modifications made on petitioner's original income tax returns for the years 1981 and 1983 were inadequate. Secondly, the Audit Division disallowed 85 percent of the claimed travel and automobile expenses on the basis of lack of substantiation. The Audit Division also disallowed claimed professional education and entertainment expenses because of lack of substantiation. Lastly, the Audit Division disallowed certain rental expenses on the ground that the property involved was not rental property.

7. At the hearing, the Audit Division conceded the accuracy of the tax returns with respect to the travel and automobile expenses and the professional education expenses.

8. In 1971, petitioner became the Chief of Radiology at Memorial Hospital in Albany, New York. In time, he developed a private practice in radiology.

9. During the years in issue, petitioner was employed as the president of Capital Radiology Associates, P.C. ("the corporation"). There were from five to six physicians associated with the corporation.

10. All of the stock of the corporation was owned by the Andrew J. Friedman Trust ("Trust"). Petitioner was the grantor of the Trust which was structured with the intention of being a Clifford Trust in accordance with the provisions of subchapter J of the Internal Revenue Code of 1954. Petitioner's son was designated as the income beneficiary of the Trust.

11. The Trust was designed to last for a period of ten years and ten days or until the death of the grantor or income beneficiary, whichever came first. The instrument creating the Trust expressly made the Trust irrevocable. Each trustee of the Trust was licensed to practice medicine.

12. Among other things, the trustees had complete custody of the Trust corpus and were directed to hold, manage, invest and reinvest the Trust corpus. The trustees were also directed to pay all of the ordinary income in the nature of interest and dividends to the income beneficiary.

13. During the years in issue, the corporation paid dividends to the Trust and the Trust, in turn, claimed an income distribution deduction.

14. During the years in issue, petitioner spent about twenty percent of his time practicing medicine, interpreting films and fluoroscopy. The balance of petitioner's time was consumed by managing the Memorial Hospital's Department of Radiology and in handling the business aspects of his medical practice.

15. In order to increase the corporation's revenues, petitioner invited physicians out to lunch or dinner. It was hoped that this practice would increase the number of patients referred to

the corporation for treatment. During the years in issue, petitioner invited other physicians out to lunch approximately four times a week. He also invited physicians to dinner approximately two times a week. Petitioner estimated that the cost of each lunch and dinner was approximately \$20.00 to \$25.00.

16. Petitioner did not maintain any contemporaneous records of his entertainment expenses. Therefore, the amounts claimed by petitioner on his tax returns for entertainment expenses were estimated.

17. In 1972, petitioner acquired a four-bedroom farmhouse which was built in approximately 1850. From 1972 until 1976, the farmhouse was rented to tenants. Starting in 1976, however, the rising cost of home heating oil resulted in discouraging prospective tenants from wishing to rent the property. During this period, petitioner considered having the farmhouse insulated. However, he was advised that this was not feasible. The farmhouse was not rented from 1976 through 1983. In 1986, the farmhouse was demolished.

18. During the years in issue, the farmhouse was listed with a real estate firm and available to be rented.

CONCLUSIONS OF LAW

A. That the New York State Administrative Procedure Act § 306(1) provides that "[u]nless otherwise provided by any statute, agencies need not observe the rules of evidence observed by courts...." Furthermore, an agency may avail itself of the records and documents in its possession (State Administrative Procedure Act § 306[2]). In view of the foregoing, it was unnecessary for the Audit Division to offer a foundation prior to the admission of a Notice of Deficiency.

B. That it is clear that the second Notice of Deficiency, issued April 12 1985, was merely duplicative of the first Notice of Deficiency and therefore superfluous. The amount of tax asserted to be due was as set forth in the Notice of Deficiency dated March 29, 1985.

C. That Tax Law § 687(a) provides that a claim for refund of an overpayment of income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever is later. In general, if the claim is filed within the three year period, the amount of the refund may not be greater than the amount of tax paid within three years immediately preceding the filing of the claim plus the period of any extension of time for filing the return. During the year 1980, the granting of the extension of time to file the Federal income tax return automatically extended the time to file the New York personal income tax return (20 NYCRR former 151.1). Accordingly, the claim for refund for the year 1980 was timely since it was filed within the three year period.

D. That the Audit Division properly concluded that petitioner was required to make the professional corporation modifications set forth in Tax Law § 612(b)(7), (8) and (9). The professional corporation modifications were enacted by Chapter 974 of the laws of 1970 as an integral part of a legislative program to permit professionals to form a professional service corporation for the practice of their profession (1970 NY Legis Ann, at 126). In 1971, the Business Corporation Law was amended to permit, in certain circumstances, shares of a professional service corporation to be held by a trust (L 1971, ch 1022; 1971 NY Legis Ann, at 129). However, there is nothing in the language of the amendments of the Business Corporation Law which indicates that said amendments were intended to allow the method of tax avoidance proposed by petitioner (Matter of Becker v. New York State Tax Commn., 89 AD2d 707). In view of the foregoing, it is concluded that the trust established herein did not relieve petitioner of the obligation of making the professional corporation modifications set forth in Tax Law § 612(b)(7), (8) and (9).

E. That an individual claiming an entertainment expense is expected to maintain records substantiating the amount of the expense, time, place, business purpose and business relationship to the person entertained (I.R.C. § 274; Treas. Reg. § 1.274-5[b][3]). Since petitioner did not maintain any records substantiating the foregoing items, he has not sustained his burden of

proving entitlement to the entertainment expenses claimed on the income tax return for 1983 (e.g.____, Matter of Philip Gioio and Louis Gioio, State Tax Commn., May 11, 1983).

F. That petitioner's rental of the property following its purchase, coupled with the facts that the property was listed with a real estate firm and that petitioner considered having the house insulated in order to make the house more attractive to prospective renters, clearly demonstrates that the house was held as rental property (see e.g., Matter of John J. Abbott, State Tax Commn., February 20, 1981). Accordingly, the Audit Division improperly disallowed the rental expenses.

G. That the petition of Robert C. Friedman is granted to the extent of Conclusions of Law "B" and "F" and the Audit Division is directed to modify the Notice of Deficiency dated March 29, 1985 accordingly; that, as modified, the Notice of Deficiency dated March 29, 1985 is sustained; and that the claims for refund are denied.

DATED: Albany, New York
December 3, 1987

ADMINISTRATIVE LAW JUDGE